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ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEETING

AGENDA
8:30 a.m.
Roosevelt Room

February 2, 1976

| | | |
|---|---|---|
| 1. | Taxation of Withdrawals from a Broadened Stock Ownership Plan | Treasury |
| 2. | Social Security Tax on the Self-Employed | OMB |

OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

JAN 28 1976

MEMORANDUM TO: Economic Policy Board Executive Committee

FROM : Dale S. Collinson
Tax Legislative Counsel

SUBJECT : Taxation of Withdrawals from a Broadened Stock Ownership Plan

This memorandum presents for decision three basic options regarding the taxation of withdrawals from a Broadened Stock Ownership Plan (BSOP). Appendix One compares present law and the various options with respect to the after-tax amount that can be accumulated and the investor's rate of return. Appendix Two provides further background information.

All of the options assume these agreed features of the BSOP proposal, among others:

--Contributions to a BSOP will be currently deductible from the individual taxpayer's income.

--Earnings of a BSOP will be free of tax until withdrawn from the BSOP.

--Amounts may be withdrawn from a BSOP after seven years without penalty.

- o FIFO (first in, first out) accounting will be applied to each year's contributions and withdrawals. Thus, amounts contributed in 1976 may be withdrawn without penalty after December 31, 1982; amounts contributed in 1977 may be withdrawn without penalty after December 31, 1983; and so on.

o Earnings of a BSOP will be allocated pro rata to contributions held by the BSOP and may be withdrawn the same time as the contributions to which they are allocated.

--Amounts withdrawn from a BSOP will come out of previously deducted contributions, dividend earnings of the ESOP, net realized capital gains of the ESOP, and net unrealized capital gains of the ESOP.

The three basic options focus solely on the tax treatment of withdrawn contributions and earnings. A separate Note on the taxation of unrealized appreciation follows the description of the options.

Option One - Tax All Withdrawals As Ordinary Income

Under this option all withdrawals from a BSOP (other than unrealized appreciation in value of distributed securities), whether contributions or earnings, would be taxed as ordinary income.

Advantages

--Simple. All withdrawals are taxed the same. Separate accounting for contributions, dividends, and capital gains not required.

--Consistent with most prevalent treatment of withdrawals from retirement and profit sharing plans. All amounts withdrawn from Individual Retirement Accounts are taxed as ordinary income. Withdrawals from H.R. 10 plans and other tax qualified plans are generally taxed as ordinary income, and the availability of capital gains treatment for lump sum distributions is gradually being eliminated.

--Equitable. The rate of return under this option is equivalent to tax exemption for BSOP earnings (i.e., equivalent to treatment of tax exempt municipal bonds, while other options provide better return than tax exemption).

Disadvantages

--May appear inequitable. Unlike IRAs, H.R. 10 plans, and other tax qualified plans, BSOPs are limited to equity investments, which may be expected to generate capital gains. Full ordinary income taxation may be viewed as converting capital gains to ordinary income and, thus, as providing less favorable treatment than direct ownership or stocks. Many taxpayers may believe that the tax deferral from deducting contributions will not outweigh this disadvantage.

- o However, as Appendix A demonstrates, this Option would in fact provide a higher rate of return than direct ownership.

Option Two -- Tax All Withdrawals As Capital Gains

Under this option all withdrawals from a BSOP (other than unrealized appreciation in value of distributed securities) would be taxed at capital gains rates.

Advantages

--Simple. All withdrawals are taxed the same. Separate accounting for contributions, dividends, and capital gains not required.

--Provides greatest tax benefit.

Disadvantages

--Provides better rate of return than tax exemption for BSOP earnings (i.e., better tax treatment than for tax exempt bonds).

--Provides inducement to withdraw funds as soon as seven year holding period ends (reverse lock in). For example, withdrawals at capital gains rates could fund new contributions deductible against ordinary income; complex rules would be required to prevent this.

--Would require more restrictive rules on withdrawal to prevent conversion of ordinary income into capital gains over a short period. For example, Individual Retirement Account funds may be withdrawn upon death, disability, or the individual's attaining age 59-1/2. A similar rule could apply under Options One and Three. But it would be inappropriate under Option Two to permit withdrawals after age 59-1/2 of contributions made within the preceding six years.

--May be attacked by persons who criticize the availability of capital gains treatment for securities transactions under present law or who are concerned about tax shelters that convert ordinary income into capital gains.

oHowever, many of such persons would oppose BSOP in any event.

oGiven that BSOP is limited to low and moderate income taxpayers, full capital gains treatment may be defended as making available to the ordinary taxpayer the capital gains tax advantages now used primarily by the wealthy.

Option Three -- Combination of Ordinary Income and Capitals Gains Taxation

Under this option, contributions withdrawn from a BSOP would be taxed as ordinary income; withdrawn earnings would be taxed at capital gains rates.

Advantages

--Avoids conversion of ordinary income (deductible contributions) into capital gains while preserving capital gains treatment for BSOP earnings and, thus, avoiding argument that earnings taxed less favorably than if the stock were held directly.

Disadvantages

--More complicated than other options. Requires separate accounting for contributions and earnings and rules respecting capital loss carryovers.

oHowever, complexity would be primarily at plan level; and the individual taxpayer would receive a simple statement advising him of the consequences of withdrawals.

--Somewhat more favorable than tax exemption of earnings.

--Provides inducement for withdrawals after seven year holding period requirement satisfied, but to a lesser degree than under Option Two.

Possible modification

This option could be modified to require separate accounting for dividends, which would be taxed as ordinary income when withdrawn, and capital gains. This would increase complexity but would most closely match the tax treatment that would obtain if the individual held the stocks directly.

Note regarding separate averaging for withdrawals

Under the 1974 pension reform law, a special separate averaging rule is applicable to the ordinary income portion of a lump sum distribution from a tax qualified employee plan. The lump sum distribution is divided by ten and a tax is computed as if the recipient had no other income. The result is multiplied by ten and a fraction (representing the ordinary income portion of the total distribution).

All lump sum distributions received by an individual during his lifetime are aggregated in applying this separate averaging provision in order to prevent multiple use of the lower rate brackets. Application of such an aggregation procedure to periodic distributions from a BSOP is not considered here because of the great complexity in recordkeeping and tax computation that would result.

Note on Taxation of Unrealized Appreciation in Value of Stock Withdrawn from a BSOP.

Under present law, if stock of the employer corporation is distributed to an employee as part of a lump sum distribution, any unrealized appreciation in the stock is not taxed until the stock is sold. Consistent with the objective of neutrality as regards choice of stock, it would be appropriate under Options Two and Three to extend this rule to all stock and to all distributions. Because under Option One all withdrawals from a BSOP would be taxed as ordinary income, either unrealized appreciation would have to be taxed upon distribution of the stock or rules would be needed to maintain ordinary income treatment upon later sale of the stock.

## Appendix A
## Accumulated Investment and Rate of Return on BSOP Options [1]

| Marginal Tax Rate | Yrs. Until Withdrawal | Final Value (After Tax Accumulation) [2] | | | | Return on Investment [4] | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Current Law [3] | Opt. 1 | Opt. 2 | Opt. 3 | Current Law [3] | Opt. 1 | Opt. 2 | Opt. 3 |
| 14 | 7 | 1.49 | 1.57 | 1.70 | 1.63 | 8.19 | 9.00 | 10.23 | 9.57 |
| | 20 | 4.21 | 4.82 | 5.21 | 5.14 | 8.27 | 9.00 | 9.43 | 9.35 |
| 15 | 7 | 1.47 | 1.55 | 1.69 | 1.62 | 8.14 | 9.00 | 10.32 | 9.61 |
| | 20 | 4.12 | 4.76 | 5.18 | 5.11 | 8.22 | 9.00 | 9.46 | 9.38 |
| 16 | 7 | 1.45 | 1.54 | 1.68 | 1.60 | 8.08 | 9.00 | 10.43 | 9.66 |
| | 20 | 4.04 | 4.71 | 5.16 | 5.08 | 8.16 | 9.00 | 9.50 | 9.41 |
| 17 | 7 | 1.42 | 1.52 | 1.67 | 1.59 | 8.02 | 9.00 | 10.53 | 9.71 |
| | 20 | 3.95 | 4.65 | 5.13 | 5.04 | 8.11 | 9.00 | 9.53 | 9.44 |
| 19 | 7 | 1.38 | 1.48 | 1.65 | 1.56 | 7.90 | 9.00 | 10.74 | 9.81 |
| | 20 | 3.77 | 4.54 | 5.07 | 4.98 | 8.00 | 9.00 | 9.61 | 9.50 |
| 22 | 7 | 1.31 | 1.43 | 1.63 | 1.52 | 7.72 | 9.00 | 11.07 | 9.97 |
| | 20 | 3.53 | 4.37 | 4.99 | 4.88 | 7.84 | 9.00 | 9.72 | 9.60 |
| 25 | 7 | 1.25 | 1.37 | 1.60 | 1.47 | 7.55 | 9.00 | 11.43 | 10.14 |
| | 20 | 3.29 | 4.20 | 4.90 | 4.78 | 7.68 | 9.00 | 9.84 | 9.70 |
| 28 | 7 | 1.18 | 1.32 | 1.57 | 1.43 | 7.37 | 9.00 | 11.80 | 10.32 |
| | 20 | 3.07 | 4.04 | 4.82 | 4.68 | 7.51 | 9.00 | 9.97 | 9.81 |
| 32 | 7 | 1.10 | 1.24 | 1.54 | 1.38 | 7.13 | 9.00 | 12.34 | 10.59 |
| | 20 | 2.78 | 3.81 | 4.71 | 4.55 | 7.29 | 9.00 | 10.16 | 9.97 |
| 36 | 7 | 1.02 | 1.17 | 1.50 | 1.32 | 6.88 | 9.00 | 12.93 | 10.88 |
| | 20 | 2.51 | 3.59 | 4.60 | 4.42 | 7.07 | 9.00 | 10.36 | 10.14 |
| 39 | 7 | 0.96 | 1.12 | 1.47 | 1.28 | 6.70 | 9.00 | 13.41 | 11.13 |
| | 20 | 2.32 | 3.42 | 4.51 | 4.32 | 6.90 | 9.00 | 10.52 | 10.28 |
| 42 | 7 | 0.90 | 1.06 | 1.44 | 1.23 | 6.51 | 9.00 | 13.92 | 11.39 |
| | 20 | 2.13 | 3.25 | 4.43 | 4.22 | 6.73 | 9.00 | 10.70 | 10.43 |
| 45 | 7 | 0.85 | 1.01 | 1.42 | 1.19 | 6.33 | 9.00 | 14.47 | 11.68 |
| | 20 | 1.96 | 3.08 | 4.34 | 4.12 | 6.56 | 9.00 | 10.89 | 10.59 |

Footnotes:

1/ Stock investments are assumed to maintain a 4 percent dividend rate and a 5 percent capital gains rate over the period of the investment (gross yield equals 9 percent). The investor's marginal tax rate is assumed to remain constant.

2/ Amount withdrawn per dollar of before-tax earnings "invested," after payment of tax on withdrawals. Under BSOP options, one dollar (money at cash plus taxes deferred) would originally be invested. For current law, only amount left after payment of taxes (one dollar of before-tax earnings less taxes paid on those earnings) would originally be invested.

3/ Under current law, investments are made with after-tax dollars, which may be recovered tax free from the proceeds of the investment. Dividends and realized capital gains are taxed currently. Computations assume no realization of capital gains until year of withdrawal and reinvestment of dividends, after payment of tax.

4/ For BSOP options, rate of return on each dollar investor actually has at risk (amount of contributions less amount of deferred taxes). This represents the best measure of the investor's return. Note that under Option One (all ordinary income taxation) the rate of return equals the gross yield of the stocks, which is equivalent to tax exemption for earnings.

NOTE: Returns greater than 9 percent represent tax treatment better than tax exemptions for BSOP earnings. All BSOP options produce higher rates of return than current law, including capital gains taxation.

## Appendix B

### Tax Treatment of Withdrawals from Tax Qualified Employee Plans

Under present law, a variety of rules govern the timing, form and taxability of distributions from qualified retirement plans. These rules reflect concerns that retirement savings not be prematurely withdrawn from a retirement plan, that the bunching of income in the year of withdrawal not result in unduly high marginal tax rates, and that the tax shelter for retirement savings not be unduly prolonged beyond retirement.

1. Individual Retirement Accounts (IRAs)

(a) Timing of withdrawals. An employee who has established an IRA may not withdraw his IRA funds until he has reached age 59-1/2, or has become permanently disabled. IRA funds may also be distributed--to the employee's heirs--upon his death.

When the employee reaches age 70-1/2 he must either (i) withdraw all remaining funds in the IRA or (ii) begin withdrawals under a schedule that will ensure that funds will be distributed from the IRA no less rapidly than over the life of the employee (or the lives of the employee and his spouse), or an equivalent fixed period. Upon the death of the employee, funds remaining in the IRA must be distributed to his beneficiaries within five years or be used within that period to purchase annuities for such beneficiaries.

(b) Penalties for improper withdrawals. A nondeductible 10 percent tax penalty is imposed on premature withdrawals. If amounts are retained in an IRA after they should be distributed (i.e., if after the employee attains age 70-1/2 a required minimum distribution is not made), a nondeductible tax is imposed on the employee equal to 50 percent of the amount that should have been distributed.

(c) Rollovers. In specified cases, funds may be withdrawn from an IRA and reinvested in another IRA or a tax qualified employee plan. Such a rollover of IRA funds does not trigger income tax consequences for the employee or the penalty tax for premature withdrawals.

(d) Taxation of withdrawals. As all contributions to an IRA are deductible and all earnings of an IRA are tax exempt while held in the IRA, the employee has no tax basis in his IRA account and all IRA distributions are fully taxable. Moreover, IRA distributions are taxable as ordinary income. However, the potential for bunching of income with attendant high marginal tax rates is mitigated in two ways:

-- A recipient of an IRA distribution may use regular five-year income averaging.

-- The owner of an IRA account may direct that distributions be made over several years.

2. Keogh (H.R. 10 Plans).

(a) Timing of withdrawals. Special rules apply to Keogh Plans, employee retirement plans that cover owner-employees (owners of a sole proprietorship and owners of more than a 10 percent partnership interest) or other self-employed individuals. Owner-employees are subject to restrictions on withdrawals before retirement age identical to those applicable to IRAs. All employees are subject to rules requiring withdrawals after retirement age similar to those applicable to IRAs.

(b) Penalties for improper withdrawals. A non-deductible 10 percent penalty tax applies to premature withdrawals by an owner-employee. In addition, for the five taxable years following a premature withdrawal by an owner-employee, no contributions may be made on behalf of the owner-employee to the plan. There is no separate tax for failure to make required withdrawals but the plan may be disqualified.

(c) Rollovers. A distribution from a Keogh plan that qualifies as a lump-sum distribution (see below) may be rolled over into an IRA, but not into another tax qualified employee plan.

(d) Taxation of withdrawals. Lump-sum distributions from a Keogh plan qualify for special tax treatment. All other distributions are taxable at ordinary income rates, to the extent they do not constitute a return of an employee's own contributions. A lump-sum distribution is the distribution within one taxable year of the entire balance in the employee's account.

-- In the case of a self-employed individual (including an owner-employee), the distribution must be on account of his death or be after he has attained age 59-1/2 or become permanently disabled.

-- In the case of all other employees, the distribution must be on account of the employee's separation from the service or death, or be after the employee has attained age 59-1/2.

The taxation of lump-sum distributions is described in section I(5) below. The ordinary income treatment of other distributions is mitigated by the availability of five-year averaging and the ability under most Keogh plans to elect periodic distributions over an extended period.

3. Corporate Employee Plans

(a) Timing of withdrawals. Because corporate tax qualified employee plans are not limited to retirement plans but also include profit-sharing and stock bonus plans, there is not the same emphasis on preventing early withdrawals from the plan. For example, accumulated funds in an employee's account may be distributed from a profit-sharing plan after a fixed number of years, the attainment of a stated age, or upon the occurrence of some event such as layoff, illness, disability, retirement, death or termination of employment. On the other hand, distributions from a pension plan may not begin until the employee retires, separates from the service of the employer, or dies.

The Employee Retirement Income Security Act of 1974 imposed new vesting requirements in an effort to assure that more employees would actually receive benefits rather than just being promised benefits. In accord with this emphasis, ERISA generally provides that payment of benefits must commence no later than the 60th day after the close of the plan year in which occurs the latest of the following events.

-- The employee attains his normal retirement age under the plan or, if earlier, age 65;

-- the 10th anniversary of the year in which the employee commenced plan participation;

-- the employee terminates his service with the employer.

(b) Penalties for improper withdrawals. No special tax penalties (10 percent or 50 percent) are imposed on premature withdrawals or the failure to make required withdrawals. However, the plan may lose its tax qualification.

(c) Rollovers. Lump-sum distributions (see below) from a corporate employee plan may be rolled over into an IRA or another tax qualified employee plan.

(d) Taxation of withdrawals. Lump-sum distributions from a corporate plan qualify for special tax treatment. All other distributions are taxable at ordinary income rates, to the extent they do not constitute a return of an employee's own contributions. A lump-sum distribution is the distribution within one taxable year of the entire balance in an employee's account on account of his death or separation from the service of the employer, or after he has attained age 59-1/2. The taxation of lump-sum distributions is described in section I(5) below. Ordinary income treatment of other distributions is mitigated by the availability of five-year averaging and, in many cases, extended distribution options.

4. Retirement Annuities Under Section 403(b)

Under section 403(b) of the Code, an annuity contract may be purchased with tax deductible dollars under a salary reduction approach for the employees of a public school or charitable organization.

-- All contract rights are nonforfeitable.

-- Benefits normally will commence when the annuitant attains normal retirement age.

All benefits distributed under a section 403(b) annuity contract are taxable at ordinary income rates.

-- Benefits become taxable upon receipt

-- There are no penalties for withdrawals prior to normal retirement age.

-- Moreover, rollover treatment is not available.

5. <u>Taxation of Lump-Sum Distributions</u>

Retirement benefits generally are taxed as ordinary income under the annuity rules (section 72) when the amounts are distributed.

-- However, amounts contributed by the employee are recovered tax free.

Beginning with the Revenue Act of 1942, special rules have been provided to deal with the bunched-income problem that arises when an employee receives a lump-sum distribution in one year of retirement benefits which may have accrued over several years. Prior to 1970, such lump-sum distributions were taxed at capital gains rates. In addition, if the lump-sum distribution consisted in whole or in part of securities of the employer corporation, any unrealized appreciation in the securities was not included in the employee's income until the securities were later sold.

These rules were changed by the Tax Reform Act of 1969 because "the capital gains treatment accorded these lump-sum distributions allowed employees to receive substantial amounts of deferred compensation at more favorable tax rates than other compensation received currently." Staff of the Joint Committee on Internal Revenue Taxation, General Explanation of the Tax Reform Act of 1969, at 173. Under the Tax Reform Act, lump-sum distributions were taxable at long-term capital gains rates only to the extent that the benefits accrued during plan years beginning before January 1, 1970. The balance of the distribution qualified for special seven-year forward averaging. However, the determination of the portion of the distribution attributable to pre-1970 plan years proved very difficult, and the rules governing lump-sum distributions were again changed by ERISA.

Under present law, the portion of the lump-sum distribution that will qualify for long-term capital gains treatment is based on a comparison of the employee's years of active participation in the plan prior to January 1, 1974, and after that date.

-- That is, the capital gains portion equals the total distribution multiplied by a fraction, the numerator of which is the total number of calendar years of active plan participation in plan years prior to January 1, 1974, and the denominator of which is the total number of calendar years of active plan participation.

-- The effect is gradually to phase out the capital gains treatment of lump-sum distributions.

The balance of the lump-sum distribution will qualify, at the election of the recipient, for special 10-year forward averaging.

-- Where the distribution is made to the employee, rather than to his beneficiary after his death, the employee will qualify for the special 10-year forward averaging only if he has completed at least five years of participation before the distribution.

Under the special 10-year forward averaging provisions, the employee is taxed upon the lump-sum distribution as if he received no other income. The total distribution (including the capital gains portion) is divided by 10, the tax is computed separately on the resulting amount, and the separate tax is multiplied by 10 and a fraction representing the portion of the total distribution constituting ordinary income. The result is the tax on the ordinary income portion of the lump-sum distribution. As under prior provisions, unrealized appreciation on employer securities distributed as part of the lump-sum distribution is not included in income. When the securities are sold, any resulting gain is taxable as long-term capital gain.

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# Business Conditions Report

**January 30, 1976**

DEPARTMENT OF COMMERCE ★ UNITED STATES OF AMERICA ★



U.S. Department of Commerce
DOMESTIC AND INTERNATIONAL BUSINESS ADMINISTRATION
Bureau of Domestic Commerce

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For further information contact:

Mr. Samuel B. Sherwin, 967-5491
Mr. Charley M. Denton, 967-5223

Enquiries and suggestions are welcomed.

## INDUSTRY HIGHLIGHTS

### RETAIL SALES: STRONG GAINS CONTINUE

° Retail sales are continuing strong growth trend since early December 1975. All retail categories are sharing increase with rate of gain varying between merchandise categories.

° During four week period ending January 17, 1976 (compared to year-ago), department stores showed largest gain (26 percent), followed by automotive dealers (25 percent), and eating and drinking places (21 percent).

CURRENT ° For week ending January 17, department stores increased 24 percent, followed by sales of drug and proprietary stores, up 22 percent, and eating and drinking places, up 19 percent.

° Smallest weekly gains were sales of gasoline service stations (6 percent) and supermarkets (7 percent).

° Retail sales in first quarter 1976 are expected to rise above traditional year-to-year growth rate of 8 to 9 percent. Sales in comparable 1975 period were depressed and department stores were encumbered by extensive inventories.

### MAJOR APPLIANCES: SHIPMENTS IN DECEMBER ENCOURAGING

° After several years of sustained growth, shipments of major household appliances in 1974 were 9 percent below 1973, at 32.0 million units.

CURRENT ° In 1975, major appliance shipments dropped 24 percent below 1974, to 24.2 million units. In December, however, decrease had narrowed to 3 percent below December 1974, at 1.8 million units.

° Chest freezers is the only major appliance category reported which showed an increase in 1975, up 4 percent over 1974. (Microwave oven shipments are not yet reported, but industry estimates indicate that sales are 20 percent over year-earlier levels.)

° In December, several appliances showed significant increases over December 1974: washing machines, up 45 percent; dryers, up 30 percent; dishwashers, up 14 percent; and refrigerators, up 5 percent.

° During first half 1976, appliance shipments are expected to be 10 to 12 percent above first half 1975.

TURBINE-GENERATORS

CURRENT ° Utility orders expected to advance in 1976. (See article in Energy Related section.)

SAVINGS: RECOVERY CONTINUES

CURRENT ° 1975 closed on favorable note, as thrift institutions attracted a respectable deposit inflow in December, usually a weak and erratic deposit month.

° Mutual Savings Banks experienced a $130 million gain in December deposits, a slowdown from November revised gain of $549 million.

° Deposits for Savings and Loan Associations had a $946 million gain in December, compared with revised $2,072 million gain in November. (See chart in Business Indicators.)

AIR PASSENGER TRAFFIC: UP IN DECEMBER, DOWN FOR FULL YEAR 1975

° Passenger traffic on U.S. scheduled airlines of 13.6 billion revenue passenger miles in December 1975 was 4.4 percent above level for December 1974, according to Air Transport Association of America.

° Domestic passenger traffic in December was up 5.4 percent from same 1974 month, while international traffic was up only 0.4 percent.

° In 1975, U.S. scheduled carriers flew 158.6 billion revenue passenger miles, down 0.4 percent from 1974 level. Domestic traffic was up 1.3 percent while international traffic was down 7.4 percent.

° Improved December traffic did not keep some major airlines, including American, Eastern, and TWA, from suffering sizeable losses for full year 1975.





AIRLINE TRANSPORT MANUFACTURERS: FUTURE UNCERTAIN

° U.S. commercial jet aerospace industry consists of three major competitive airframe and two major competitive engine manufacturers supported by some 4,000 suppliers of parts and equipment.

° 84 percent of turbine-powered airliners in the world are of U.S. origin, and over one-third of these are operated by foreign airlines.

° Dollar value of Western world fleet by end of 1974 was 95 percent U.S. composition, a value that increased substantially during previous ten years.

° Many countries, particularly those within the Economic Community, are determined to reduce their reliance on U.S. aerospace products by developing their own competitive product lines.

CURRENT ° Firm order backlog of U.S. built jetliners is now at all time low, down 50 percent from 1968 highs.

° Employment by transport aircraft manufacturers in 1974 declined 7,000. Estimates of 1975 drop are 5,000, and projections for 1976 indicate a further decline of 5,000 to a low of 53,400. (126,200 were employed by this industry in 1968.)

MATERIALS HANDLING EQUIPMENT: BOOKINGS REMAIN SLUGGISH

CURRENT ° Shipments in first eleven months 1975 totaled $1.87 billion, 9.5 percent below same 1974 period.

° November bookings for eight major segments of materials handling equipment industry totaled $138.9 million, down 10.5 percent from November 1974.

° Seasonally adjusted bookings index figure for November 1975 (based on 1967 average per month) declined to 131.8, or 20 points below October level of 151.9. Index low of 125.8 was reached in May.

° Manufacturing industry is apparently not actively increasing purchases of materials handling equipment but is activating existing facilities to increase production.

° Historically, orders for materials handling equipment lag an economic turnaround by about 6 months.

## ELECTRONICS/RECEIVING TUBES: RCA TO CLOSE REMAINING PLANT

° Domestic production of receiving tubes has declined by nearly 80 percent since 1966, as transistors and integrated circuits have taken over their functions in new radios and TV receivers.

° Most of remaining demand for tubes is for replacement in older sets.

CURRENT ° RCA announced it will close its last remaining tube producing facility, located in Harrison, New Jersey, in mid-1976. Harrison plant is source of estimated 30 percent of U.S. output of receiving tubes. Some 1,100 workers will be affected.

° RCA, sole source for nearly 110 types of receiving tubes, is expected to continue to accept orders for tubes and fill them from overseas sources.

## BICYCLE INDUSTRY: 50 PERCENT DECLINE IN 1975

CURRENT ° Unit sales of bicycles in 1975 were 5.4 million domestic and 1.8 million imports, representing total unit sales of 7.2 million, a 50 percent decrease from 1974.

° Total dollar value of 1975 bicycle sales is estimated at approximately $800 million, down 43 percent from 1974 record of $1.4 billion.

° U.S. imports of bicycle products for first eleven months 1975 were $97 million, slightly less than 28 percent of U.S. market. (Imports represented 28 percent of U.S. market in 1974 and 33 percent in 1973.)

° U.S. exports totaled $2.6 million for first eleven months 1975, below total 1974 year exports of $4.3 million.

° New Consumer Product Safety Commission regulations effective May and November 1976 establish standards for bicycle manufacture of brakes, pedals, wheels, frames, and reflectors. Estimates place additional retail cost per bicycle from $1 to $10.

° Industry projections for 1976 indicate unit sales will increase 35 percent to 9.1 million units, with sales of domestic units increasing 33 percent.





## MILITARY EQUIPMENT: NATO TAKES STEPS TO BOOST SALES TO U.S.

° Trade balance on overall military equipment between U.S. and NATO members runs about 10 to 1 in favor of U.S., according to an electronics trade journal.

° At recent NATO meeting, U.S. representative told other members that U.S. could not increase military purchases from Western Europe until manufacturers there adopted NATO-wide standards.

CURRENT ° NATO has established European Defense Procurement Agency to standardize military hardware and boost sales to U.S.

° Move is designed more fully to integrate European defense industry and to make it more cost-effective, and less dependent on U.S. material.

° France, Europe's largest exporter of military equipment, is outside NATO's procurement structure, but NATO is prepared to develop some accommodation for France.

## BANKING/BONDS: OWNERSHIP OF NEW YORK BONDS

CURRENT ° Banks own more New York City and state obligations than previously disclosed, according to new Federal Reserve study. Bulk of increase is $2 billion of state-agency obligations that were not reported before.

° Fed study shows that 954 banks in 33 states own $6,490 million of New York obligations: $2,017 million in city obligations; $1,476 million in state obligations; and $2,997 million in state-agency obligations.

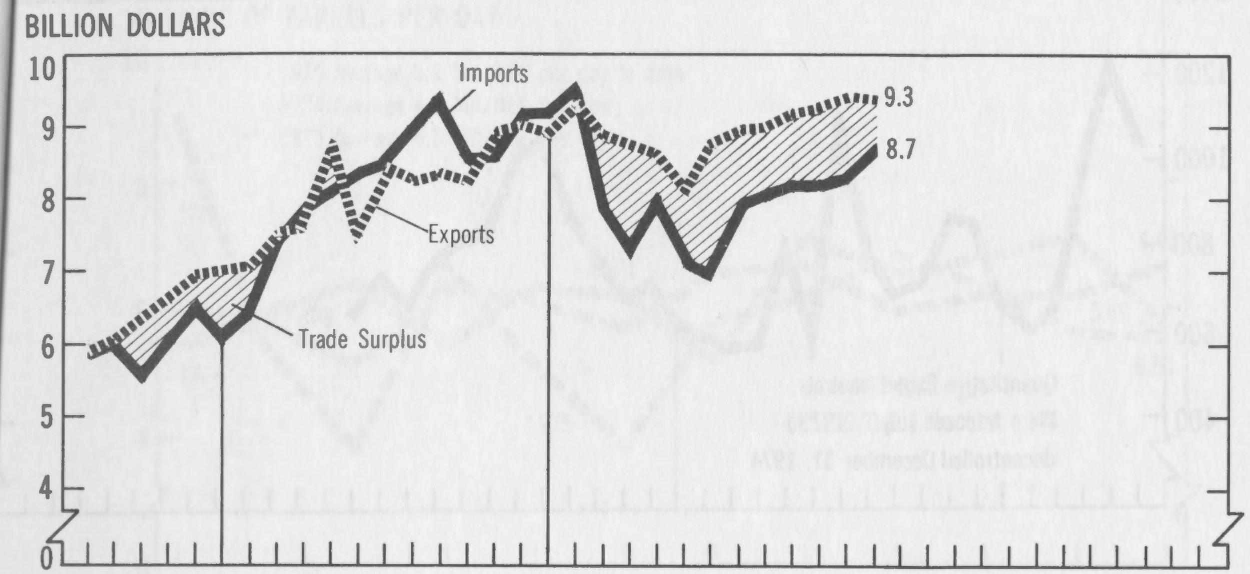
° City and state obligations make up more than 50 percent of capital of 234 banks in 29 states, and between 20 percent and 50 percent of capital of 718 banks in 33 states.

° New York banks hold most of the bonds, $5,147 million; Florida is second with $226 million; Alabama third with $107 million; and Pennsylvania fourth with $96 million.

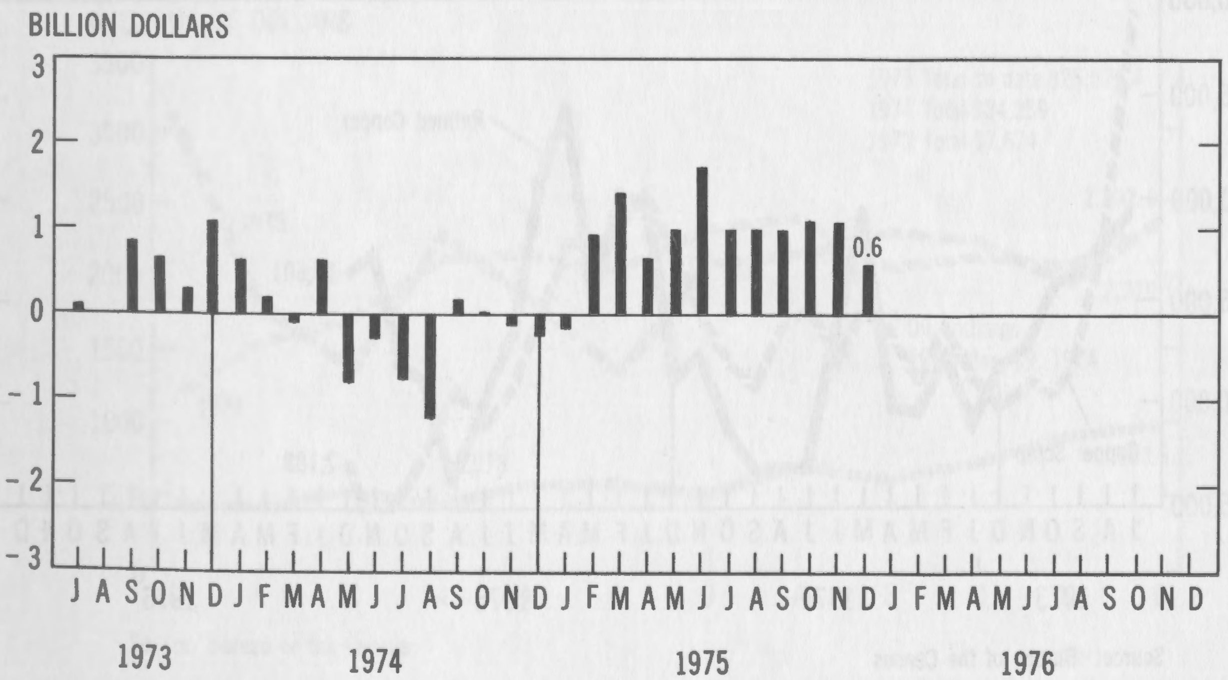
# BUSINESS INDICATORS

## MERCHANDISE IMPORTS AND EXPORTS

**(Seasonally Adjusted)**

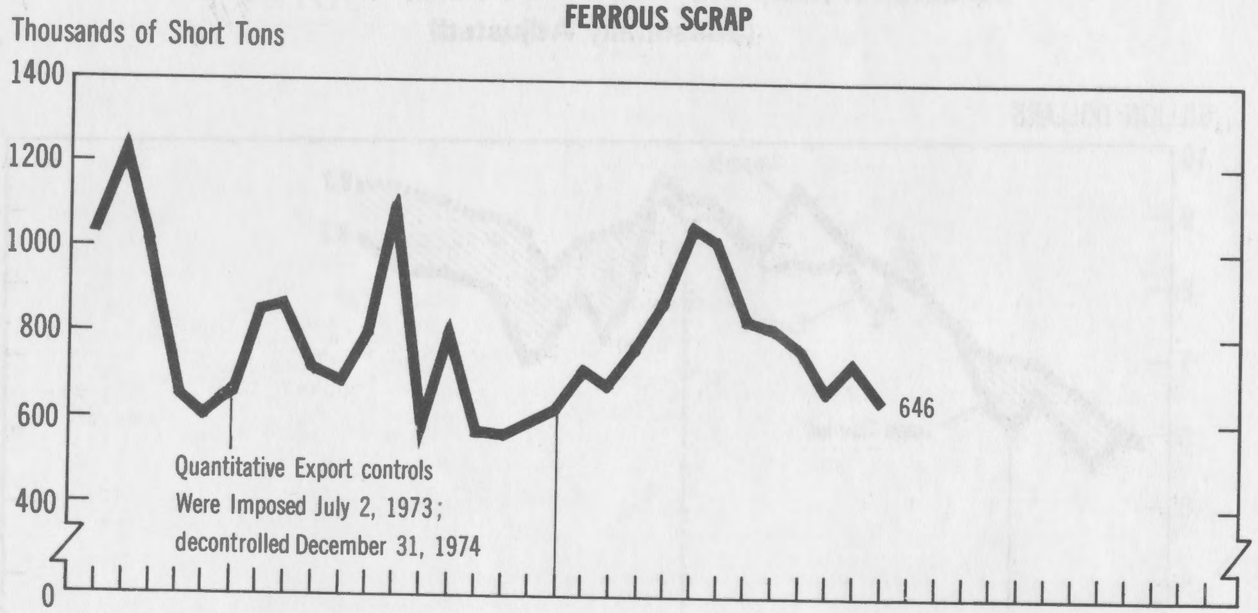


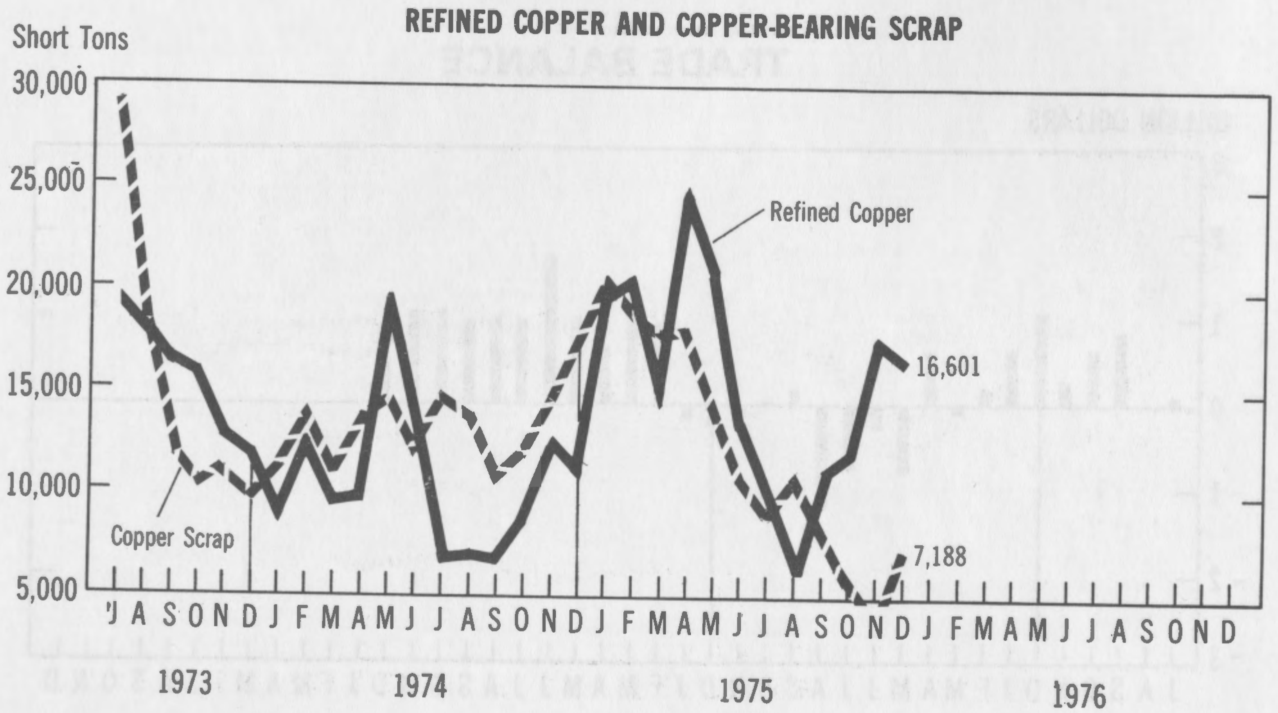

## TRADE BALANCE




Source: Bureau of the Census

## KEY COMMODITIES — U.S. EXPORTS



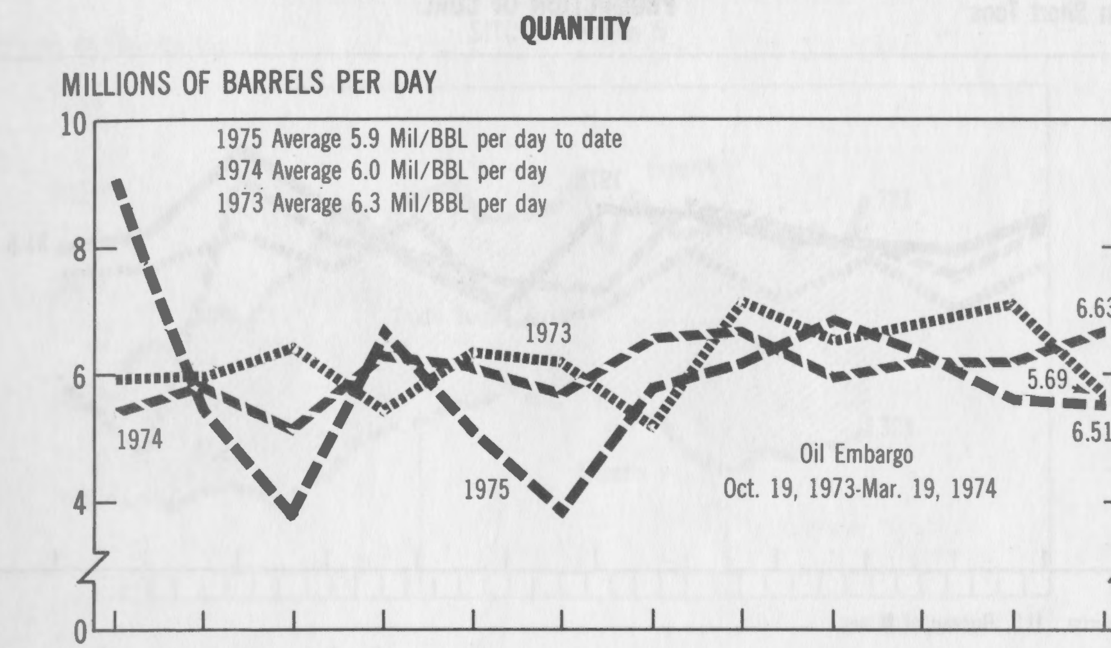




Source: Bureau of the Census

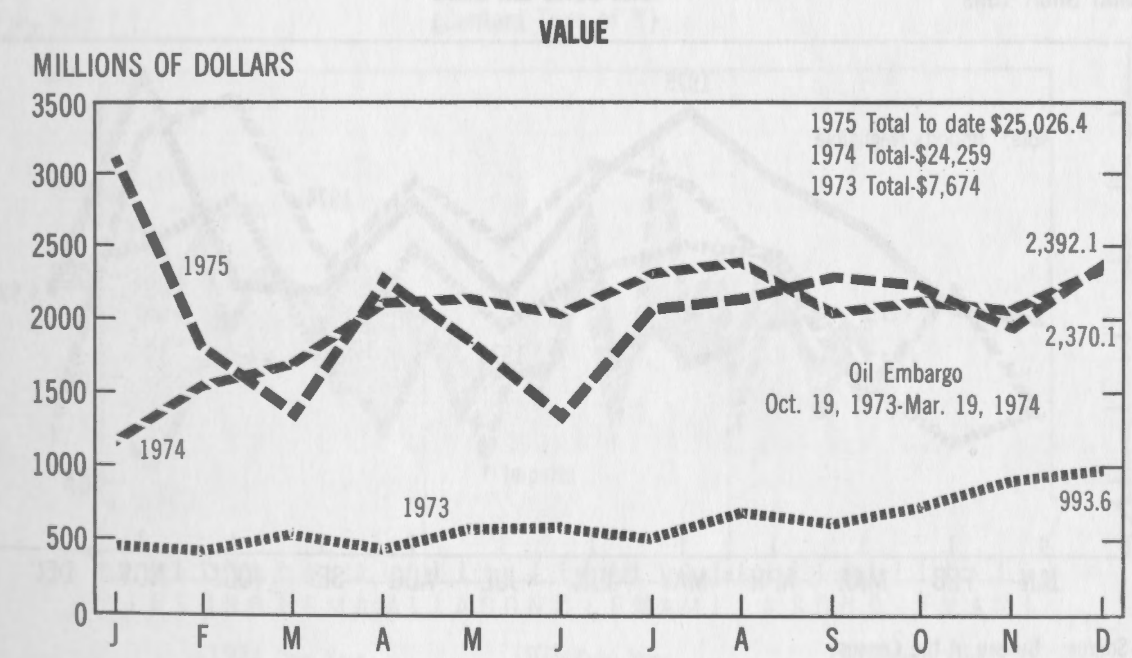


## U.S. PETROLEUM IMPORTS FOR CONSUMPTION

### CRUDE AND REFINED PRODUCTS




Source: Bureau of the Census

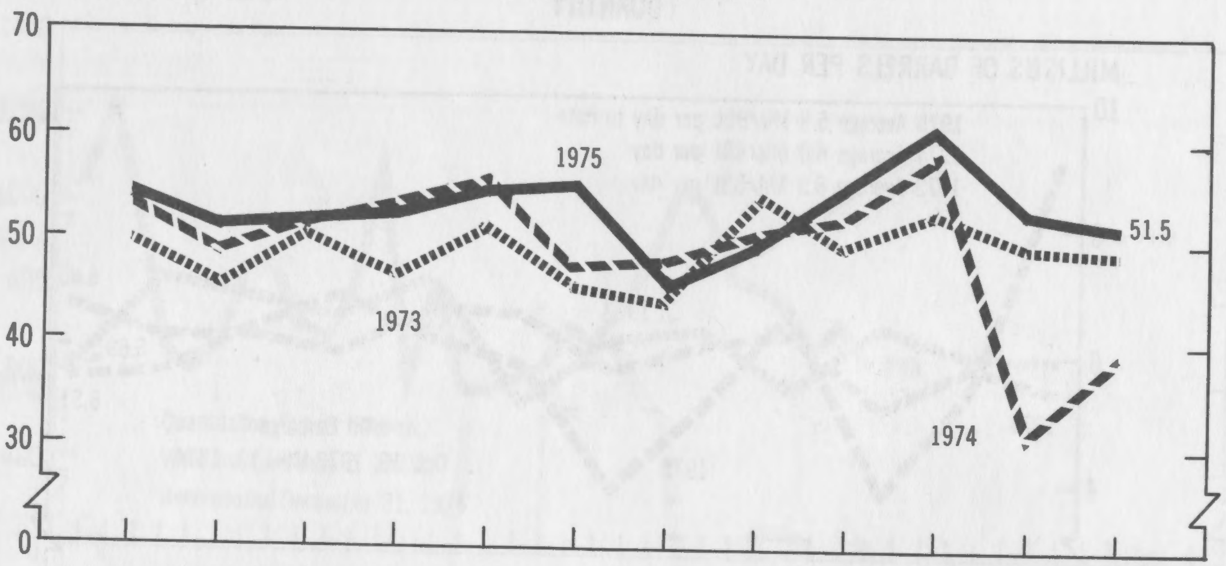



Source: Bureau of the Census

# COAL

Million Short Tons

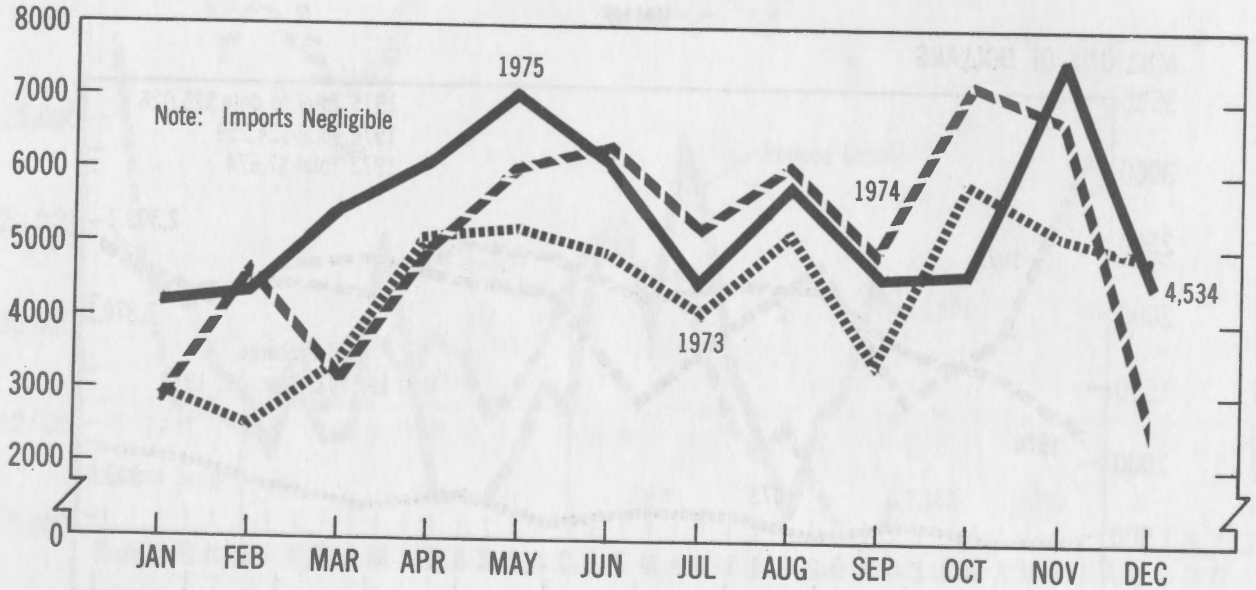
**PRODUCTION OF COAL**




Source: U.S. Bureau of Mines

Thousand Short Tons

**U.S. COAL EXPORTS**



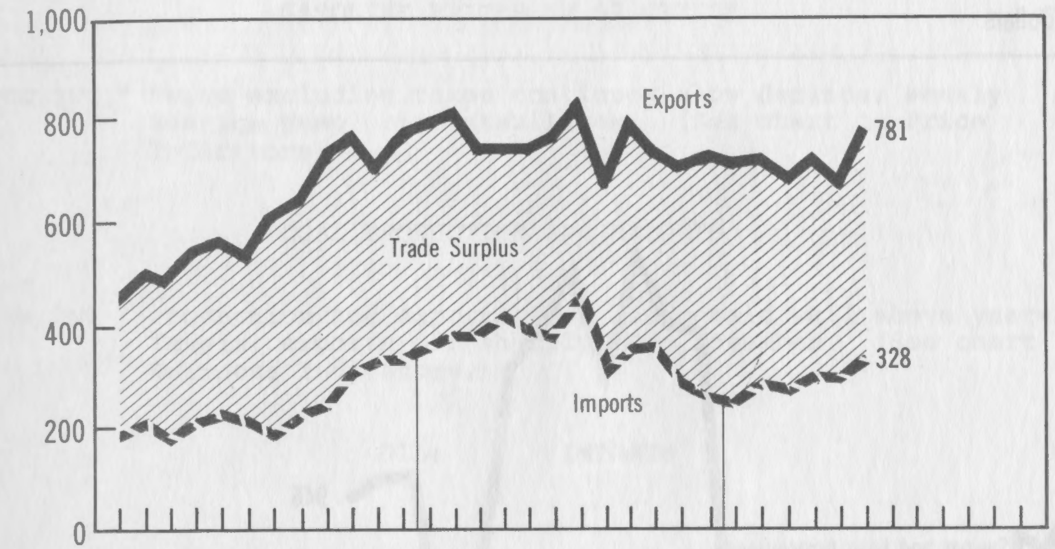

Source: Bureau of the Census



# CHEMICALS

**SITC – Section 5**

Millions of Dollars

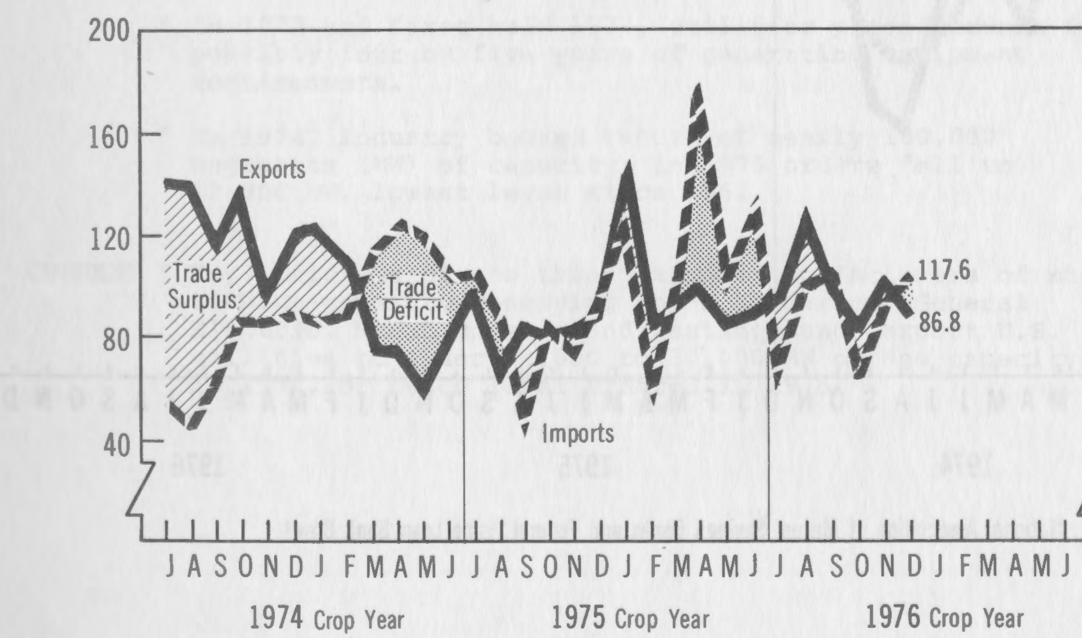



Source: Bureau of the Census

# NITROGENOUS FERTILIZERS

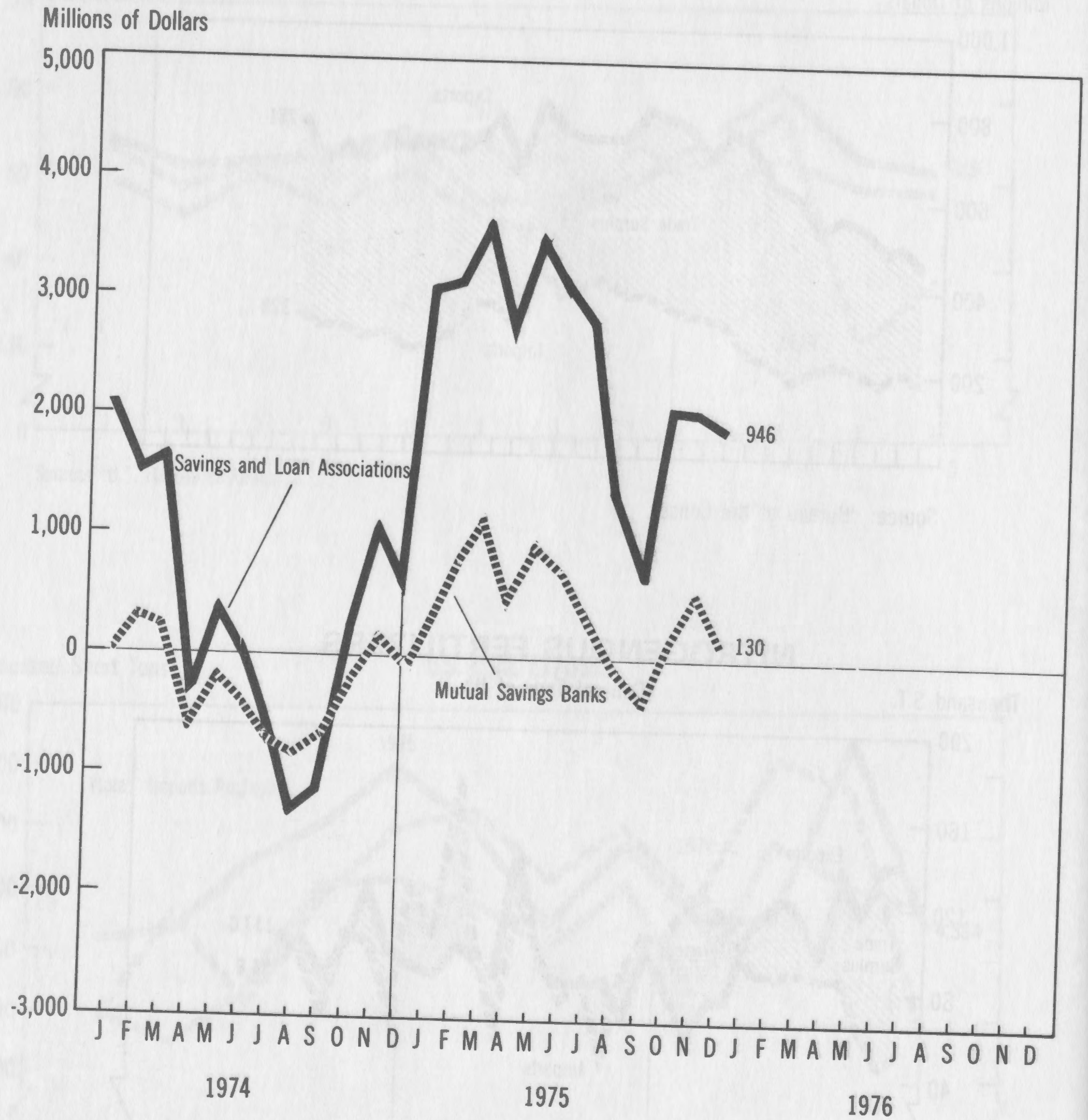
**(Content Tons of N)**

Thousand S.T.




Source: Bureau of the Census

# SAVINGS FLOWS IN THRIFT INSTITUTIONS




Source: National Association of Mutual Savings Banks and Federal Home Loan Bank Board





ENERGY RELATED

GASOLINE PRICES IN 52 CITIES

CURRENT ° Price excluding taxes continues slow decline; weekly average pump price stabilizes. (See chart in Price Indicators.)

COAL PRODUCTION AND EXPORTS

CURRENT ° Production and exports drop but remain well above year-ago levels; exports off sharply from November. (See chart in Business Indicators.)

OIL: IMPORTS

CURRENT ° In December, imports were up 22 percent in value and 15 percent in daily average quantity over November. (See chart in Business Indicators.)

TURBINE-GENERATORS: UTILITY ORDERS IN 1976 EXPECTED TO ADVANCE

° In 1973 and first half 1974, utilities placed orders for possibly four or five years of generating equipment requirements.

° In 1974, industry booked record of nearly 100,000 megawatts (MW) of capacity; in 1975 orders fell to 12,900 MW, lowest level since 1962.

CURRENT ° Key officials of the three largest manufacturers of steam turbine-generators serving the U.S. market, General Electric, Brown Boveri, and Westinghouse expect U.S. utilities to order 20,000 to 30,000 MW of new capacity in 1976, or twice level ordered in 1975.

° Marketing officials for turbine vendors appear to expect advance in industrial sector of the economy, a boost in peaks and kilowatt-hour (kw.-hr.) sales, and generally stronger financial condition of utilities in forecasting rise in turbine-generator.

CONSERVATION/CONSTRUCTION: NEWLY CONSTRUCTED BUILDINGS COULD SAVE 27 PERCENT IN ENERGY CONSUMPTION

° In August 1975, American Society of Heating, Refrigeration and Air Conditioning Engineers (ASHRAE) completed its standard 90-75, designed to reduce energy consumption in new buildings.

° Standard covers: building envelope (walls, doors, windows, roof, etc.); heating, cooling and ventilation; domestic hot water systems; illumination; and electrical distribution systems.

CURRENT ° Standard "could reduce the annual energy consumed in new construction by about 27 percent," if adopted by all 50 states, according to study by Arthur D. Little, Inc.

° Standard, if adopted, would produce annual energy cost savings of 9 to 15 percent for new single-family houses and 30 to 45 percent for new commercial buildings.

° Report further states that although design service costs will be higher, construction costs may actually be lower.

° Energy cost savings could offset higher design costs within a few years (from 2.5 to 7.6 years depending on type of structure).

° Reportedly many states and localities have adopted standard in their building codes, and many more are expected to do so.

CONSERVATION/GASOLINE: ADOPTION OF "WESTERN RULE" COULD CONSERVE 50 MILLION GALLONS PER YEAR

° So-called Western Rule, followed in 29 states, permits right turns on red lights, thereby reducing gasoline consumption by vehicles idling at light-controlled intersections.

° Based on Virginia's estimates of gasoline savings of 5.1 million gallons per year by permitting right turns on red lights at 80 percent of its intersections, Highway Users Federation for Safety and Mobility (HUFSM) estimates possible savings of 50 million gallons of gasoline per year if remaining 21 states and District of Columbia adopted the Western Rule.





SUPPLY SITUATIONS

MAGNESIUM: NL INDUSTRIES SUSPENDS OPERATIONS

° NL Industries, Inc. (formerly National Lead Company) began limited operations at its Rowley, Utah, $70 million primary magnesium plant in December 1972, with rated annual capacity of 90 million pounds.

° New plant utilized brine from Great Salt Lake and new process embodying system of solar evaporating ponds. Firm reportedly held patents on processing of raw material and on a continuous closed electrolytic cell system.

° Firm has had continuous operational problems, with production at a highly curtailed level. In September 1975 Norsk Hydro a.s of Oslo, Norway, was called in as a problem solving consultant.

CURRENT ° NL Industries has announced that beginning February 1976, Rowley plant will suspend operations for minimum of 10 months to evaluate cell modifications designed to correct technical difficulties, and to allow additional time for anticipated construction and modification program.

° Plant closing, which will affect 250 of 600 employees, leaves U.S. with two primary magnesium producers, and reduces annual installed capacity by 26 percent, from 350 million pounds to 260 million pound.

° Given low levels of production at this plant, and present economic conditions, impact of plant closing is negligible.

° Remaining producers are Dow Chemical U.S.A. (240 million pounds capacity) and American Magnesium Company (20 million pounds capacity)

COPPER: ANOTHER REFINERY TO CLOSE

° In April 1975, Anaconda Company closed its Perth Amboy, New Jersey copper refinery. Capacity was 115,000 tons, 3.5 percent of U.S. total capacity.

° In late 1975, ASARCO closed its Baltimore copper refinery. Capacity was 318,000 tons, 10.0 percent of U.S. total capacity.

° On January 5, 1976, Copper Range reduced its production at its White Pine mine in Michigan by 80 percent and laid off 72 percent of its work force. Refinery capacity is 90,000 tons, 2.8 percent of U.S. total capacity.

° Last week AMAX announced it will reduce copper production at its Carteret, New Jersey refinery by an unspecified amount. Capacity is 85,000 tons, 2.6 percent of U.S. total capacity.

CURRENT ° On January 21, 1976, ASARCO announced it will close its 81 year-old Perth Amboy copper refinery in March 1976, laying off 600 workers. Capacity is 168,000 tons, 5.1 percent of U.S. capacity.

° Company cited high fuel and labor costs and difficulties in meeting environmental regulations.

° ASARCO will increase production at its new Amarillo, Texas plant from 216,000 tons to 280,000 tons in second quarter 1976 with further increases dependent on copper market. (Amarillo plant has capacity of 420,000 tons, 12.8 percent of total U.S. capacity.)

° Above plant closures and reductions in production are result of depressed market conditions.

° Present operating rate of industry in U.S. is approximately 80 percent of capacity.

## COAL-DERIVED CHEMICALS: COKE BATTERY CLOSINGS NOT TO AFFECT SUPPLIES

° EPA ordered closing of three coke producing batteries at U.S. Steel Corporation Works, Gary, Indiana, and batteries closed on December 31, 1975 as ordered by Department of Justice (see BCR 1/2/76).

° Coke operations produce such chemicals as benzene, toluene, xylene, phenol, etc. These chemicals, however, are produced primarily from petroleum, with the overall supply of these chemicals from coke-ovens accounting for less than 5 percent of total supply.

CURRENT ° Coke battery closings will not cause shortage of these chemicals, as this coal-derived segment of chemical industry has been operating below capacity and only supplements chemicals produced from petroleum.





# LABOR DEVELOPMENTS

## WAGES: HIGHEST AND LOWEST MEDIAN HOURLY WAGE GAINS NEGOTIATED IN 1975

° 1975 all-industries median wage gain was 54.9 cents an hour. (See Business Conditions Report, January 9, 1976.)

CURRENT ° Industries in which highest hourly median wage increases were negotiated are: cement, 84.7 cents; construction, 75.2 cents; petroleum, 74.9 cents; lumber, 67.9 cents; rail transportation, 58.2 cents; shipping, 53.3 cents; and trucking and warehousing, 50.3 cents.

° Industries in which lowest hourly median wage increases were negotiated are: apparel, 18.7 cents; leather, 24.5 cents; textiles, 25.1 cents; and education, 25.4 cents.

## DEFERRED PAY RAISES: 5.5 MILLION WORKERS AFFECTED

° In 1976, 5.5 million private non-farm workers covered by major collective bargaining agreements will receive deferred pay raises averaging 5.4 percent.

° In addition, more than 4.6 million workers under major contracts (includes 3.4 million workers receiving deferred raises) are scheduled for wage reviews in 1976 because of cost-of-living clauses in contracts.

° Approximately 5.9 million workers under major agreements are currently covered by escalator clauses.

## NEGOTIATIONS: MAJOR NEW CONTRACTS IN FIRST QUARTER 1976

° At least 4.4 million workers are covered by major collective bargaining agreements that will expire or have reopening provisions in 1976. (See Business Conditions Report, December 19, 1975.)

° First quarter 1976 is important in that trucking industry will be negotiating contracts for 420,000 workers.

° By month, major contact negotiations and workers involved for first quarter, 1976 are:

-- January, apparel, 85,000; motion pictures and TV, 20,000; and trucking and warehousing 12,000.

-- February, apparel, 8,400.

-- March, trucking and warehousing, 408,000; services, 20,000; and utilities, 5,300.

STRIKES
(Source: Federal Mediation and Conciliation Service)

° During week ending January 21, approximately 47,500 employees were involved in 245 work stoppages throughout the United States.

° Six work stoppages were in major and/or significant category where 1,000 or more employees were in bargaining unit.

° During approximately same year-ago period, there were 195 work stoppages, involving 61,100 employees. Eight stoppages were in major and/or significant category.

NEW AND SETTLED MAJOR STRIKES
(Source: Federal Mediation and Conciliation Service)

° New:

Peabody Coal Company
and the SEIU
Louisville, Kentucky
(Ohio, Muhlenberg Co., Ken.
and Hopkins City, Kentucky)
1,160 employees; began 1/21/76

° Settled:

Madison Public Schools
and the Madison Teachers Assn.
Madison, Wisconsin
1,900 employees; 1/5/76 through 1/18/76

Pittsburgh School District
and the Pittsburgh Federation
of Teachers
Pittsburgh, Pennsylvania
5,100 employees; 12/1/75 through 1/26/76





CANADIAN PAPER INDUSTRY STRIKES: WORKERS END STRIKE AT FOUR QUEBEC NEWSPRINT MILLS

CURRENT ° 3,500 striking Canadian Paperworkers Union (CPU) workers have ratified new three-year agreement to end three-month walkout at four Quebec paper mills. These mills account for about 10 percent of Canada's total newsprint capacity of approximately 10.2 million tons.

° Pact, subject to review by Canada's Anti-Inflation Review Board, generally falls within Board's previous guidelines: 14 percent wage boost first year (retroactive to May 1, 1975), 10 percent second year, and 8 percent in final year.

° Settlement leaves 21,000 CPU members on strike at pulp and paper mills in Ontario, Quebec, and the Maritime Provinces, but may be important trend-setter in forthcoming contract settlements.

° In New Brunswick, CPU has rejected identical contract offer from Miramichi Timber Resources, LTD., subsidiary of Boise Cascade Corp., Boise, Idaho.

° U.S. newspaper publishers, 70 percent dependent on Canadian newsprint, report inventories near 30 days, down from 60 days and more in November 1975.

## PRICE DEVELOPMENTS

### COFFEE: PRICES INCREASE AGAIN

- Coffee supplies are expected to be reduced due to severe frost in Brazil, civil war in Angola, and heavy rains in Colombia. These nations normally produce half of world's coffee.
- U.S. wholesale price of coffee has risen sharply in past few months as result of worldwide reduction of supplies.

CURRENT

- General Foods Corp. (Maxwell House, Yuban, Sanka, Brim, and Max-Pax) is boosting the wholesale price of its ground coffee 10 percent (15 cents a pound) and freeze-dried coffee 7 percent (2 cents an ounce).
- Procter and Gamble (Folger's) raised prices similarly last week.
- Nestle is considering price increases for its Nescafe and Taster's Choice Brands.
- Total increase in wholesale price for ground coffee since August 1975 has been 54 percent, and 47 percent for freeze-dried coffee. Although retail prices have risen, some retailers have partially absorbed the wholesale increases.

### PERISHABLE CUTTING TOOLS: PRICES INCREASED

- Producers see improvement in orders in 1976 provided that recent upswing in business from automotive and other consumer oriented industries continues. (See Business Conditions Report, January 23, 1976.)

CURRENT

- National Twist Drill Co. of Rochester, Michigan, a leading drill manufacturer, increased prices on drills, reamers, counterbores, milling cutters, and saws by 6 percent as of January 12.
- Some manufacturers are expected to follow National's lead while others will evaluate situation.
- 7.5 percent increase in high speed tool steel prices on January 5 and increased energy and labor costs were factors contributing to increase in cutting tool prices.
- Incoming orders for the industry, though improved, are still sluggish, leaving some producers hesitant to increase prices.

° Many producers are operating at 60 to 70 percent of capacity and fear customer resistance to new price increases.

PLASTICS: PRICE INCREASES EXAMINED

° During past 10 months, various price increases for plastic materials went into effect. Producers justified increases generally as due to "higher costs."

° Price of ABS plastics (natural grade) ranged from 22 to 40 cents per pound in January 1971 compared to 40 to 51 cents per pound in December 1975.

CURRENT ° Specific cost details have been traced by Borg-Warner Chemicals, leading producer of ABS plastics.

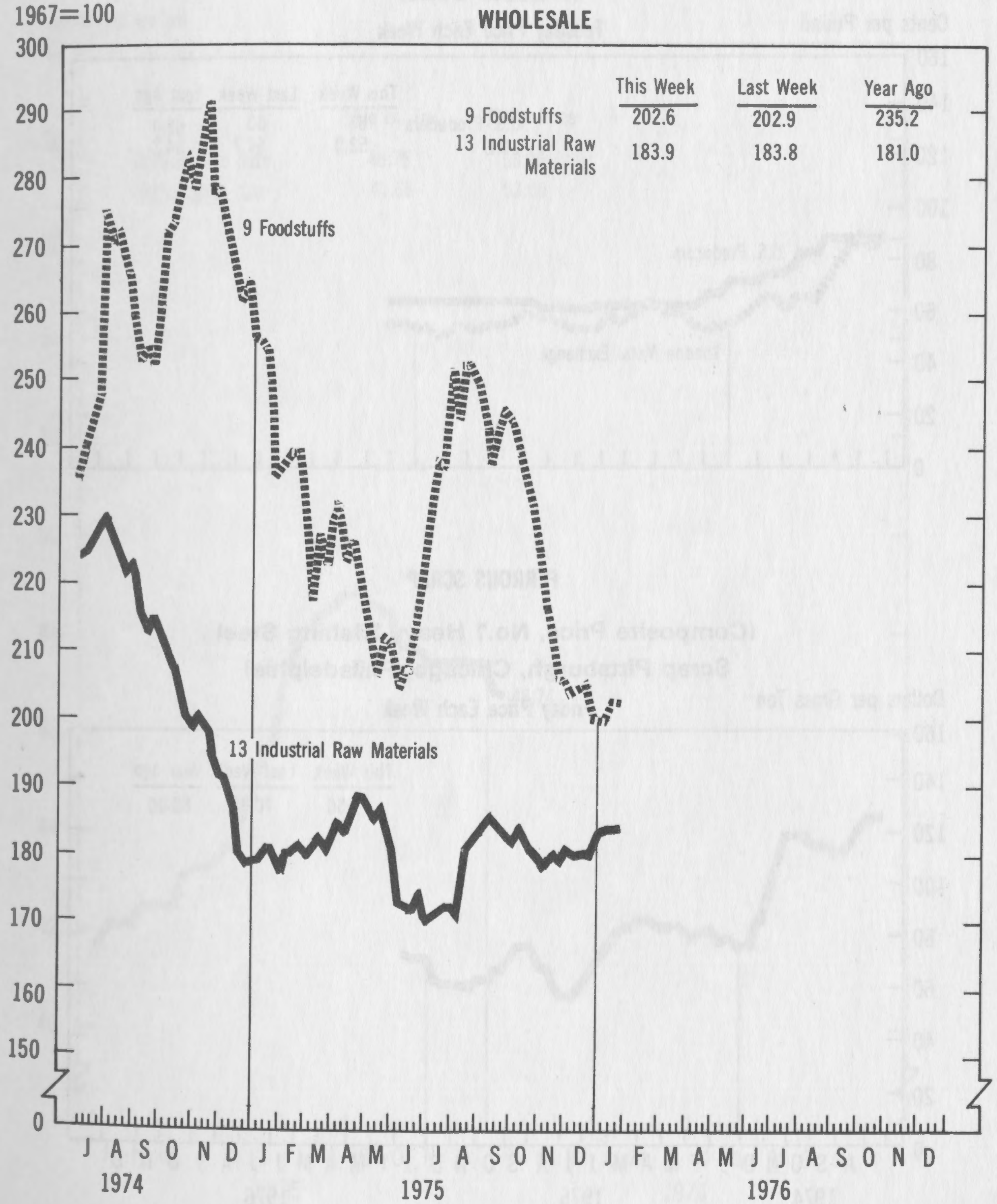
° Based on 1971 = 100, following indices were developed by Borg-Warner for those cost factors besides raw materials contributing to higher prices for ABS:

| | | |
|---|---|---|
| -- | Utilities | 254 |
| -- | Labor | 157 |
| -- | Other Direct Costs 163 (includes maintenance, quality control, packaging, supplies, outside services, etc.) | 163 |
| -- | Overhead (includes taxes, depreciation, insurance, etc.) | 199 |



# PRICE INDICATORS

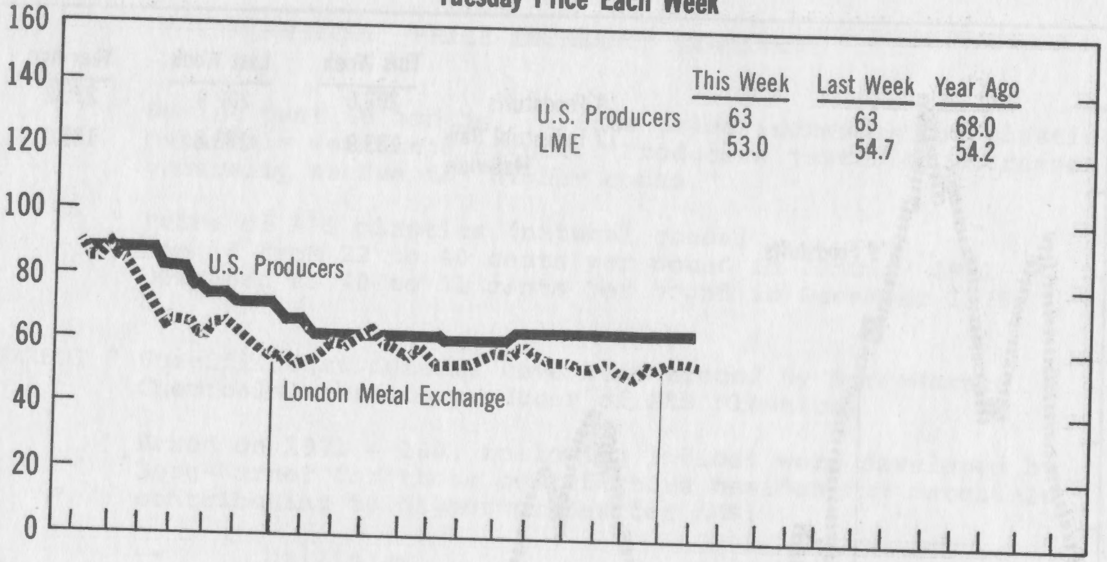
## TUESDAY SPOT PRICES



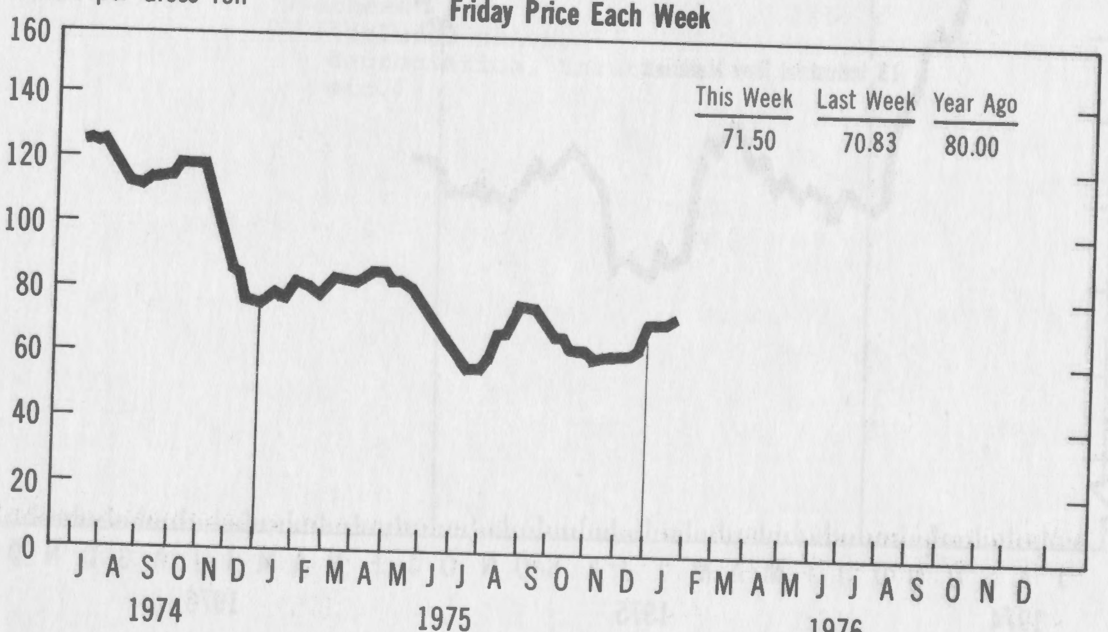

Source: Department of labor

# KEY COMMODITY PRICES

### COPPER PRICES
### (Wirebar Basis)
**Tuesday Price Each Week**




### FERROUS SCRAP
### (Composite Price, No.1 Heavy Melting Steel Scrap Pittsburgh, Chicago, Philadelphia)
**Friday Price Each Week**

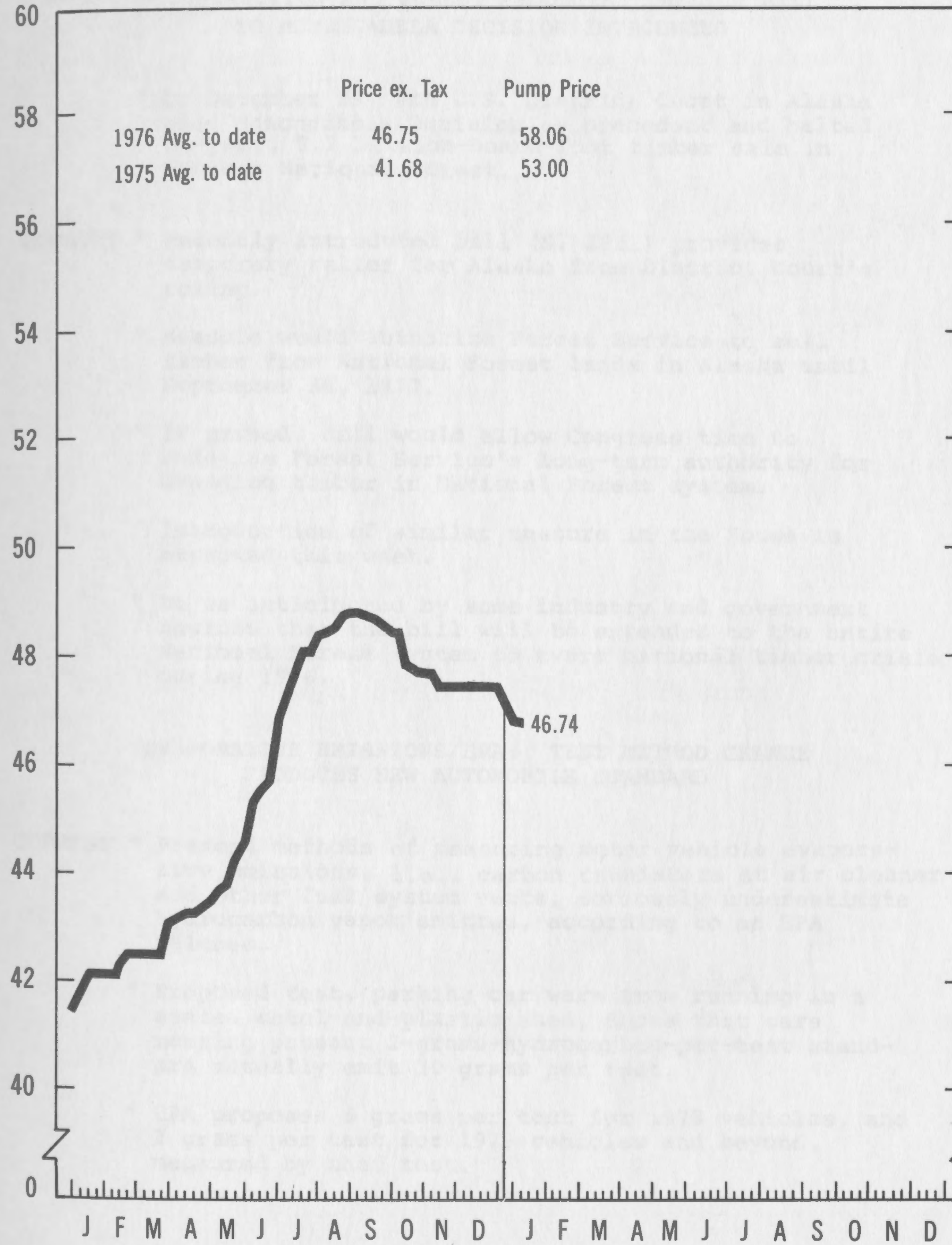



Source: American Metal Market



# GASOLINE PRICES IN 52 CITIES

### WEEKLY AVERAGES[1]




[1] Prices exclude Federal, state and local taxes ranging from 9¢ to 13¢

Source: Oil and Gas Journal

## DEVELOPING ISSUES

### CONSTRUCTION AND FOREST PRODUCTS: RELIEF BILL TO MONONGAHELA DECISION INTRODUCED

° On December 29, 4th U.S. District Court in Alaska used Monongahela Decision as precedent and halted 50-year, 8.2 billion-board-foot timber sale in Tongass National Forest.

CURRENT ° Recently introduced bill (S. 2851) provides temporary relief for Alaska from District Court's ruling.

° Measure would authorize Forest Service to sell timber from National Forest lands in Alaska until September 30, 1977.

° If passed, bill would allow Congress time to redefine Forest Service's long-term authority for managing timber in National Forest system.

° Introduction of similar measure in the House is expected this week.

° It is anticipated by some industry and government sources that the bill will be extended to the entire National Forest system to avert national timber crisis during 1976.

### EVAPORATIVE EMISSIONS/EPA: TEST METHOD CHANGE PRODUCES NEW AUTOMOBILE STANDARD

CURRENT ° Present methods of measuring motor vehicle evaporative emissions, i.e., carbon cannisters at air cleaner and other fuel system vents, seriously underestimate hydrocarbon vapor emitted, according to an EPA release.

° Proposed test, parking car warm from running in a sealed metal-and-plastic shed, shows that cars meeting present 2-grams-hydrocarbon-per-test standard actually emit 30 grams per test.

° EPA proposes 6 grams per test for 1978 vehicles, and 2 grams per test for 1979 vehicles and beyond, measured by shed test.

° EPA estimates $11.00 sticker price increase should cover added costs of new standard with no adverse effect on fuel economy.

° Better gas tank caps and improved vapor storage cannisters with purge valves will allow present cars to meet new standard. (Vega, Plymouth Duster, and fuel injected Volkswagens already meet it).

° Industry accepts $11 increase through 6-gram per test standard (1978) but won't estimate price add-on for 2-grams per test standard (1979).

° At present there are no evaporative emission standards for heavy trucks. EPA is developing test procedure for future heavy truck standard.

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